

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
43RD STREET DEVELOPMENT CO.	:	DETERMINATION
	:	DTA NO. 811125
for Revision of a Determination or for Refund	:	
of Tax on Gains Derived from Certain Real	:	
Property Transfers under Article 31-B of the	:	
Tax Law.	:	

Petitioner, 43rd Street Development Co., c/o Weisman and Weisman, 21 East 40th Street, New York, New York 10016, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 18, 1993 at 1:15 P.M., with all briefs scheduled to be submitted by December 6, 1993. Petitioner appeared by Dreyer and Traub, Esqs. (Michael Discafani, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (David C. Gannon, Esq., of counsel).

ISSUES

I.(a) Whether the Division of Taxation properly denied petitioner's refund claim in the sum of \$48,796.60, the basis of which was petitioner's belief that it erroneously included costs paid by its transferee in its calculation of consideration.

(b) Whether a Bankruptcy Court Order, dated August 7, 1990, effected a transfer of real property to petitioner as of June 14, 1990 for the purposes of Tax Law Article 31-B.

II. Whether petitioner was entitled to increase its refund claim in its amended petition to include reimbursement by its transferee of costs incurred in the operation and maintenance of the property in issue ("negative carry") for the period June 14, 1990 through the closing date.

FINDINGS OF FACT

New York International Hostel, Inc. ("Hostel") was the fee title owner of the real

property located at 255 West 43rd Street, New York, New York (the "property"). The property was subject to a mortgage in the amount of \$8,425,000.00 held by petitioner, 43rd Street Development Company ("43rd Street"), the first mortgagee.

Hostel filed for Federal bankruptcy protection in an action under Chapter 11 of the United States Bankruptcy Code. As part of the case, the United States Bankruptcy Court for the Southern District of New York ordered that the property be auctioned for sale to the highest bidder. Subsequently, a public auction was conducted by the Bankruptcy Court examiners on June 14, 1990. When no other bids were received during the auction, the Bankruptcy Court accepted 43rd Street's credit bid in the amount of its first mortgage. Failure by 43rd Street to submit a credit bid in the amount of its first mortgage would have caused 43rd Street to lose its status as a secured creditor.

Judge Tina L. Brozman of the United States Bankruptcy Court issued the Order, dated August 7, 1990, approving the acceptance of 43rd Street's credit bid. The Order governed the conduct of the parties to the actual sale and defined each party's rights, duties and obligations.

The decision to accept the credit bid of petitioner was based on:

"[t]he Examiner and other interested parties hav[ing] advanced sound business reasons for seeking to sell the Property by way of an auction sale as [being] in the best interests of the estate. The record and all prior proceedings herein sufficiently establish that time is of the essence for the disposition of the Property and that a resolution of the myriad issues would entail extended delay and substantial potential reduction in the value of the Property."

The bid was also deemed fair and reasonable under the circumstances.

The Court designated petitioner as "purchaser" and ordered the debtor/ fee holder, Hostel, to transfer the property to petitioner, by bargain and sale deed, without any limitation on the fee except the first mortgage. The property was to be transferred free of all encumbrances.

Petitioner was authorized to operate and manage the property, and was granted possession as of June 14, 1990 at 5:00 P.M. until the date of closing, i.e., the transfer date from Hostel to petitioner. Petitioner was also authorized to collect and receive all income and rents from the property beginning June 14, 1990 and was charged with the duty to insure the property. The prior manager, Berger Hotels Corp., delivered the property to petitioner on June 14, 1990, and

was thus relieved of all liability thereafter. Berger was merely a management company used by the Court to preserve the bankrupt's estate. It never had a fee interest.

Paragraph "D" of the Order defined the term "purchaser" as 43rd Street, its designee or assignee. Paragraph "8" of the Order required the "purchaser" to pay the fees of the bankruptcy examiners. In Paragraph "9" of the Order, the Bankruptcy Court deemed possession of the property to be delivered to the "purchaser" as of June 14, 1990 as follows:

"9. Possession of the Property is deemed delivered to the Purchaser as of June 14, 1990 at 5:00 p.m., and the Purchaser is authorized and empowered to operate and manage the Property from said date to the closing hereof. The Purchaser is authorized and empowered to collect and receive all income and rents from June 14, 1990 and thereafter, and shall not be liable or responsible for any costs or expenses in connection with operating the Property incurred or accrued for any period prior to June 14, 1990. The Purchaser shall insure the Property and the estate's interest therein pending the closing of the Sale."

Accordingly, the "purchaser" was authorized and empowered to collect income and rents; to operate and manage the property; and to insure the property and the Bankruptcy Estate's interest pending the closing of the sale. Paragraph "15" of the Order explicitly provided that:

"[t]his Order shall be binding upon and inure to the benefit of the estate and the Purchaser and their respective successors and assigns"

Moreover, Paragraph "16" of the Order provided that the Bankruptcy Court continued to retain jurisdiction over the parties and the property until the actual date of sale, to the extent necessary to effectuate the sale and to enforce the terms and conditions of the provisions of the Court's Order.

The initial closing was ordered to be by September 7, 1990. However, additional Bankruptcy Court orders were subsequently obtained extending the closing date until April 1, 1991. The reason for the subsequent orders was that the City of New York Department of Housing Preservation and Development became interested in the property for use as a single-room occupancy hotel by the homeless and AIDS patients. The Department of Housing Preservation and Development ultimately agreed to fund an acquisition loan to Common Ground Community HDFC, Inc. ("Common Ground"), a New York not-for-profit corporation, to acquire the property from Hostel for the intended purpose.

On February 28, 1991, 43rd Street and Common Ground entered into an agreement for the assignment (the "assignment agreement") of 43rd Street's right, title and interest as "purchaser" under the Order. The assignment agreement provided: (1) that 43rd Street would transfer, convey or assign to Common Ground its right, title and interest as "purchaser" under the Order; (2) that Common Ground would accept the assignment and assume the obligations of the "purchaser" under the Order including the obligation to manage and operate the property; (3) that Common Ground would reimburse 43rd Street for the actual expenses incurred by 43rd Street in the operation of the property from June 14, 1990 through the closing date of the assignment, such that it was the intent of the parties that 43rd Street would be reimbursed or made whole insofar as possible and not realize any profit or gain; (4) that it was the intent of the parties that Common Ground take title to the property as 43rd Street's designee pursuant to the Order; (5) that Common Ground would pay any real estate taxes and water and sewer rents for the period covered by the Order; and (6) that Common Ground would take the premises subject to the first mortgage held by 43rd Street, which was to be satisfied within 180 days of closing. Common Ground was also to pay \$809,644.66 to 43rd Street in actual expenses and losses incurred in the operation of the premises from June 15, 1990.

The assignment agreement set forth the amounts to date of closing to be reimbursed to 43rd Street for the actual costs of managing and operating the property during the period that 43rd Street was deemed in possession by the Bankruptcy Court. 43rd Street was required by Common Ground to engage a New York City accounting firm to review the books and records of 43rd Street in connection with the reimbursed costs of managing and operating the property. The actual expenses and losses incurred were as follows:

Weisman & Weisman legal fees accrued since inception of bankruptcy proceeding June 1988	\$125,000.00
Interest on loan	21,921.66
Legal fees to Bruce Roswick and Jack Lerner	20,457.00
John Huber Management Fee	25,000.00
Arthur Schwebel Management Fee	75,000.00
Operating Losses from 6/15/90 to 3/14/91	<u>542,266.00</u>
Total	\$809,644.66

The assignment closed on March 25, 1991, at which time a gains tax was paid in the

amount of \$101,661.93.

Prior to the transfer, a transferor questionnaire, dated March 6, 1991, was filed which set forth 43rd Street as the transferor of a contract assignment to Common Ground, for gross consideration of \$1,305,248.66, less acquisition costs of \$288,629.40, yielding gain subject to tax of \$1,016,619.26, and anticipated tax of \$101,661.93. The following exhibit was attached to the transferor questionnaire:

"EXHIBIT A
43rd Street Development Co., Transferor
Form TP-580

"An interest in real property includes an option or contract to purchase real Property. Tax Law Section 1440.4. 'Transfer of real property' is defined as the transfer or transfers of an interest in real property by any method including assignment. Tax Law Section 1440.7. The assignment of the Transferor's right to purchase the property located at 255 West 43rd Street, New York, New York 10036 (the 'Property') is therefore subject to the Gains Tax.

"Pursuant to Tax Law Section 1443.1(b) and NYCRR Section 590.55, for purposes of determining the application of the \$1,000,000.00 exemption, the purchase price under the contract is added to the amount of consideration received for the assignment. For purposes of this filing, it will be assumed that the \$1,000,000.00 exemption is not applicable to the assignment at issue.

"Consideration

"Pursuant to Paragraph 3 of the assignment agreement dated February 28, 1991 (copy attached), the transferee will pay to the transferor actual out of pocket expenses incurred in the operation of the Property; such that it is the intent of the parties that the Transferor be made whole, without profit or gain. Amounts being paid by the transferee to the transferor include:

Attorney fees paid to Weisman and Weisman	\$ 125,000.00
Interest on loans	21,921.66
Attorney fees paid to Bruce Roswick and Jack Lerner	20,457.00
Management fee to John Huber	25,000.00
Management fee to Arthur Schwebel	75,000.00
Operating losses of the Transferor from the Property	<u>546,644.00</u>
Sub Total	\$ <u>814,022.66</u>

Pursuant to the assignment agreement, the transferee shall pay:

Real Estate Taxes on the Property from 6/14/90 - 3/14/91	\$ 455,445.00
Water and sewer charges 6/14/90-3/14/91	30,579.00
'Gross up' for deeds stamps paid by Transferee ¹	<u>5,202.00</u>
Total Consideration	\$1,305,248.66

"¹ The Transferee has agreed to pay the New York State Real Property Transfer Taxes (the 'Deeds Stamps') in connection with the assignment. Pursuant to NYCRR Section 590.15 and Tax Law Section 1440.1(a), the consideration paid for the assignment must include the 'gross up' for the Deed Stamps paid by the transferee. The 'gross up' is computed as follows: \$1,300,046.66 is rounded up to \$1,300,500.00 x .4% = \$5,202.00.

"Original Acquisition Costs

Weisman and Weisman (attorney fees)	\$ 175,000.00
Bruce Roswick, Esq. (attorney fees)	41,129.40
Alan Nisselson, Esq. (examiners fee) ²	60,000.00
Ephraim Leibowitz (attorney fee) ²	12,500.00
	\$ 288,629.40

"² Fees were ordered to be paid by the Bankruptcy Court pursuant to the order dated August 7, 1990."

The transferee questionnaire filed by Common Ground indicated the consideration to be paid by it, \$1,305,248.66, but listed the interest to be acquired as "other", with no explanation in the record. Both questionnaires listed March 14, 1991 as the anticipated date of transfer, but the actual closing took place on March 25, 1991.

A tentative assessment and return was issued pursuant to these questionnaires setting forth tax due in the sum stated by the transferor in its questionnaire. Approximately three weeks later, on April 9, 1991, 43rd Street filed a claim for refund.

By letter, dated May 3, 1991, the Division of Taxation ("Division") denied, in part, the refund application of 43rd Street, stating, in pertinent part, as follows:

"We have considered the above referenced refund claim dated April 9, 1991 in the amount of \$49,371.10.

"The basis of the claim is as follows:

"A) Certain costs paid by the transferee were erroneously included in consideration.

"B) Legal fees were incurred in connection with the assignment which were not claimed on the original submission.

"Section 1440.1(a) of the Tax Law provides that, 'Consideration means the price paid or required to be paid for real property or any interest therein, less any customary brokerage fees related to the transfer if paid by the transferor, including payment for an option or contract to purchase or use real property. Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation.'

"A review of the U.S. Bankruptcy Court Order defines the purchaser of the property as 43rd Street Development Co., its designee or assignee. The order also states that possession of the property is deemed delivered to the purchaser as of June 14, 1990.

"Since claimant acquired the right to receive fee title to the property, the outstanding real estate taxes and sewer charges became the obligation of the claimant.

"On February 28, 1991 claimant entered into an agreement to assign its interest in the subject property to Common Ground Community HDFC, Inc. ('CGC'). Paragraph 7(F) of the agreement provides that CGC shall pay real estate taxes, sewer and water charges for the period prior to July 1, 1990.

"In accordance with Section 1440.1(a) of the Tax Law, the relief of the claimant's obligation to pay these charges is deemed to be consideration.

"Therefore, the amount of the real estate taxes, sewer and water charges were correctly included in the consideration received by the claimant.

"Regarding the second issue, the legal fees incurred during the assignment have been accepted as filed.

"Accordingly a refund in the amount of \$574.50, plus interest will be forwarded to the proper department for processing."

Petitioner appealed this denial to the Bureau of Conciliation and Mediation Services. By Conciliation Order, dated June 19, 1992, the conferee denied petitioner's appeal and sustained the Division's denial of the refund application, as modified.

Petitioner filed a petition, dated August 17, 1992, with the Division of Tax Appeals. The Division filed its answer to the petition, dated December 30, 1992. Petitioner filed an amendment to the petition, dated July 1993, which increased the amount of refund claimed from \$49,371.10 to the entire amount of tax paid by petitioner, \$101,087.43, less the \$574.50 allowed

for legal fees by the Division (see, Finding of Fact "9"). The Division submitted an amended answer in response, dated August 10, 1993.

CONCLUSIONS OF LAW

A. The first issue that must be discussed is whether the Order of the Bankruptcy Court, dated August 7, 1990, effected a transfer of a beneficial interest in the real property at 255 West 43rd Street, New York City, to petitioner within the meaning and intent of Tax Law § 1440.4.

The Order stated that an auction of the property took place on June 14, 1990, after "adequate and sufficient" notice was provided, and the credit bid of petitioner was recommended by the examiner and ordered by the Court (see, Findings of Fact "3" and "4").

Finally, the Court retained jurisdiction over the parties and the property to the extent necessary to effectuate the sale and enforce the terms of the Order.

Petitioner argues that since the Court retained jurisdiction, petitioner could have been removed from possession at any time, just like Berger Hotels Corp. It contends that it was merely a lender, never intended to purchase the property, and was, at most, an intermediary in the actual transfer of title to the ultimate purchaser, Common Ground. However, the facts indicate differently.

Petitioner was a purchaser in possession pursuant to its credit bid at the auction on June 14, 1990. The Court's Order anticipated a closing to occur prior to September 7, 1990 between Hostel and petitioner and placed it in possession as of the auction date. Petitioner replaced Berger Hotels Corp. as manager of the facility pending its acquisition of title. Berger Hotels was never a purchaser of the property and never had any interest in the property; its role in managing the property should not be confused with petitioner's unique position. Petitioner's illustrations of how constrained it was under the Order miss the point. Petitioner did not gain title under the Order, only the right to receive it; therefore, it would be expected that petitioner would insure the property for the estate pending closing, would not depreciate the property until it was owned and would follow the provisions of the Order until closing. As for its suggestion that it could not freely transfer the property, it is submitted that petitioner did just that -- to

Common Ground.

Tax Law § 1440.4 states:

"'Interest' when used in connection with real property includes, but is not limited to, title in fee, a leasehold interest, a beneficial interest, an encumbrance, a transfer of development rights or any other interest with the right to use or occupancy of real property or the right to receive rents, profits or other income derived from real property. Interest shall also include an option or contract to purchase real property."

Clearly, given the provisions of the Order, petitioner had an interest in the real property. Not only did it have the right to use and occupancy of the property and the right to receive rents, profits and income therefrom, petitioner had a court order directing the debtor to convey the real property to it; interest even stronger than the option or contract to purchase referred to in the statute.

B. Tax Law § 1441 imposes a tax at the rate of 10% on gains derived from the transfer of real property within New York State. There is no dispute that the transfer of property herein constituted a transfer subject to this tax.

Tax Law § 1440.3 defines "gain" as the "difference between the consideration for the transfer of real property and the original purchase price of such property, where the consideration exceeds the original purchase price.

Tax Law § 1440.5 defines "original purchase price" to mean:

"the consideration paid or required to be paid by the transferor;

"(i) to acquire the interest in the property, and (ii) for any capital improvements made or required to be made to such real property"

"Consideration", in turn, is defined by Tax Law § 1440.1(a) to mean:

"the price paid or required to be paid for real property or any interest therein Consideration includes any price paid or required to be paid, whether expressed in a deed and whether paid or required to be paid by money, property, or any other thing of value and including the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether the underlying indebtedness is assumed or taken subject to. Consideration includes the cancellation or discharge of an indebtedness or obligation."

In Matter of Cheltoncort Co. (Tax Appeals Tribunal, December 5, 1991, confirmed 185

AD2d 49, 592 NYS2d 121), the Tribunal stated that:

"In calculating the amount of tax due upon a taxable transaction, the value of the consideration has to be determined at the time of the transfer in order to finally fix the tax owed. Subsequent events do not alter the value that the consideration had at the time of the transfer" (emphasis added).

In the instant matter, the transfer/assignment of petitioner's interest in the real property, its court-ordered right to receive unencumbered title to the property, occurred on March 25, 1991. The real property gains tax due on the transaction was determined as of that date. Petitioner filed a transferor questionnaire which stated total consideration of \$1,305,248.66, of which \$491,226.00 was real estate taxes due for the period June 14, 1990 through March 14, 1991, water and sewer charges for the same period and the "gross up" for deed stamps paid by the transferee. Petitioner contended after the fact in its refund application that these costs should not have been included in consideration. However, the facts dictate otherwise.

First, in the agreement between petitioner and Common Ground, the parties agreed to file an application to the Bankruptcy Court for a determination that the premises would be transferred free of all claims for real estate taxes, water, sewer and vault charges prior to July 1, 1990 (§ 21). Therefore, the parties contemplated responsibility for the taxes and charges after July 1, 1990 to the March 25, 1991 closing date.

As noted in the Court Order of August 7, 1990, petitioner was the purchaser and anticipated transferee and party responsible for the taxes and charges. The Order stated that petitioner specifically waived any claim that liens for taxes and charges after July 1, 1990 were invalid or avoidable by reason of the Bankruptcy Code.

Petitioner, as purchaser under the Order, was responsible for these liens and was relieved of this responsibility by its assignee, Common Ground. Under Tax Law § 1440.1(a) cited above, this qualifies as consideration, the price paid for petitioner's interest in real property. By assuming petitioner's obligation to pay the liens for real estate taxes and other charges, by agreeing to take the property subject to those liens, the parties increased the consideration paid for the interest being transferred.

C. The final issue to be discussed is whether the purported "negative carry" should be excluded from consideration. However, it is first necessary to decide if petitioner's request to

increase the amount of its refund claim was proper. The Division argues that such an increase is contrary to the terms of Tax Law § 1445(1) and (2). The Division reasons that petitioner's claim for a greater amount is beyond the jurisdiction of the Division of Tax Appeals, as it exceeds the amount set forth in the refund request, the denial of which gave petitioner its standing before this forum (citing Matter of Gasit, Inc., Tax Appeals Tribunal, July 19, 1990, confirmed 171 AD2d 325, 576 NYS2d 402, appeal dismissed 79 NY2d 1040, 584 NYS2d 448).

However, petitioner argues that its application is timely based on Matter of Allied Aviation Serv. Co. of N.Y. (Tax Appeals Tribunal, June 27, 1991). The last sentence of Tax Law § 1445.3 is substantially similar to the last sentence of Tax Law § 1139(c), one of the sales tax provisions controlling the refund of sales tax. The last sentence of Tax Law § 1445.3 states as follows:

"No refund or credit shall be made of a tax, interest or penalty paid after a determination by the tax commission made pursuant to section fourteen hundred forty-four unless it be found that such determination was erroneous, illegal or unconstitutional or otherwise improper, by the tax commission after a hearing or of its own motion, or in a proceeding under article seventy-eight of the civil practice law and rules, pursuant to the provisions of said section, in which event refund or credit shall be made of the tax, interest or penalty found to have been overpaid."

In Matter of Allied Aviation Serv. Co. of N.Y. (supra), the Tribunal analyzed Tax Law § 1139(c), which sets forth a series of separate rules that apply where the tax has been paid after a notice of determination has been issued. The Tribunal stated:

"Pertinent to our inquiry is the last sentence of section 1139(c) which states:

'No refund or credit shall be made of a tax, interest or penalty paid after a determination by the commissioner of taxation and finance made pursuant to section eleven hundred thirty-eight unless it be found that such determination was erroneous, illegal or unconstitutional or otherwise improper, by the division of tax appeals pursuant to article forty of this chapter or by the commissioner of taxation and finance of his own motion, or in a proceeding for judicial review provided for in section two thousand sixteen of this chapter, in which event a refund or credit shall be made of the tax, interest or penalty found to have been over paid.'

"We agree with petitioner that this sentence means that tax paid pursuant to a notice of determination that on review is held to be erroneous by the Division of Tax Appeals or by the courts is automatically to be refunded to the taxpayer, without the need for an application. Since no application is required, the time limitations of section 1139(a) on such application have no relevance. Thus, we

conclude that petitioner is not barred by the limitations of section 1139(a) from recovering any portion of the amount it paid in response to the notice of determination."

It is of critical importance that both the sales tax statutes and the gains tax statutes speak to the situation where a determination has been made by the Division pursuant to sections 1138(a) or 1444. That was not the case herein and petitioner's reliance on Allied Aviation was misplaced.

Petitioner, by its amended petition, dated July 1993, raised a second, separate claim for refund, based on a new theory for a different and distinct amount, i.e., all amounts paid in excess of those for which a refund application had been made, based upon the theory that the tax was based on "negative carry" which should not have been included in consideration. The amended petition was filed more than two years after the later of the date of transfer or the date the tax was paid, as set forth in the first claim for refund dated "4/9/91". Therefore, in accordance with Tax Law § 1445.3, this forum does not have jurisdiction to review the untimely filing.

Assuming, arguendo, that the claim was timely filed, petitioner's argument that the charges it incurred in managing and operating the property between June 14, 1990 and March 25, 1991 were "negative carry" is without merit.

"Negative carry" was defined in the context of a cooperative conversion in Matter of 1230 Park Associates (Tax Appeals Tribunal, July 27, 1989, confirmed 170 AD2d 842, 566 NYS2d 957, lv denied 78 NY2d 859, 575 NYS2d 455) as the excess of maintenance and management charges on the apartments related to the unsold shares, over receipts derived from these apartments. As pointed out in the parties' briefs, the concept was also discussed in Matter of 61 East 86th Street Equities Group (Tax Appeals Tribunal, January 21, 1993). However, the concept has always been raised in the context of cooperative conversions and in the establishment of original purchase price. The petitioners in the two cited cases argued that "negative carry" should be allowed as a "customary, reasonable and necessary expense . . . incurred to create [an] ownership interest . . . in [real] property in cooperative or

condominium form" (Tax Law § 1440[5][a]). The Tribunal rejected the argument on the basis that these expenses were not incurred to create an interest in real property.

Petitioner herein reasoned that since it incurred a loss managing the real property, it would characterize the loss as "negative carry". If one were to accept this characterization, petitioner would then urge that such expenses must be eliminated from the consideration it received on the transfer of the real property. But neither 1230 Park Associates nor 61 East 86th Street Equities Group addressed the elimination of negative carry from consideration, but rather from original purchase price. The fact that petitioner and Common Ground bargained at arm's length and in good faith and determined that a fair consideration for the property was the cost to make petitioner whole, places the entire amount paid by Common Ground within the definition of "consideration" as found in Tax Law § 1440.1(a) and the gain was properly taxed after allowance for original purchase price.

D. The petition and amended petition of 43rd Street Development Co. seeking review of the Division's denial of its application for refund, dated April 9, 1991 and July 1993, are denied.

DATED: Troy, New York
May 19, 1994

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE